Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I Transaction Unit
Knowledge Base – Corporate/Business Issues & Credits

Library Level	Number	Title
Shelf		Corporate Issues
Book	225	Transaction Costs
Chapter	4	Treatment of Costs in a Corporate Separation
Section		

Unit Name	Transaction Costs in a Corporate Separation	
Primary UIL Code	263.14-00	Allocation Between Capital Expenditure and Expense

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Issue and Transaction Overview

Transaction Costs in a Corporate Separation

A corporation ("distributing corporation") that distributes the stock of a controlled subsidiary ("controlled corporation") in a tax-free transaction described in IRC 355, such as a spin-off, split-off or split-up ("corporate separation"), often incurs legal fees, accounting fees, consulting fees, investment banking fees and other costs (collectively, "transaction costs") in connection with the transaction. The corporate separation may be executed as a stand-alone transaction, as part of a tax-free divisive reorganization described in IRC 368(a)(1)(D) ("divisive 'D' reorganization"), or as part of a broader corporate restructuring.

A distributing corporation "controls" a subsidiary corporation if the distributing corporation owns stock of the subsidiary with at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all other classes of the subsidiary's stock. See IRC 368(c).

The distributing corporation might deduct the transaction costs incurred as professional fees or as an abandonment loss in the year the corporate separation is completed. Current law requires the capitalization of costs that facilitate a reorganization under IRC 368 and a distribution of stock under IRC 355. See Treas. Reg. 1.263(a)-5(a)(4); *Bilar Tool & Die v. Commissioner*, 530 F.2d 708 (6th Cir. 1976).

In the year the corporate separation is completed, both the distributing corporation and the controlled corporation may claim a deduction for transaction costs previously capitalized as facilitating the distributing corporation's acquisition of the controlled corporation's stock. A deduction claimed for previously capitalized transaction costs is often reported as an abandonment loss or a loss from the impairment of an intangible asset. Under current law, transaction costs incurred by the distributing corporation that facilitated its acquisition of the controlled corporation's stock may not be recovered until the controlled corporation dissolves. See, e.g., *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992). In a corporate separation, the controlled corporation does not dissolve; rather, its stock is distributed to shareholders of the distributing corporation.

This Practice Unit discusses the treatment of transaction costs when a taxpayer engages in a corporate separation, including:

1. Costs that facilitate the separation transaction,
2. Facilitative costs the distributing corporation capitalized when it acquired the controlled corporation's stock in a tax-free transaction, and
3. Facilitative costs the controlled corporation capitalized when the distributing corporation acquired its stock.

Issue and Transaction Overview (cont'd)

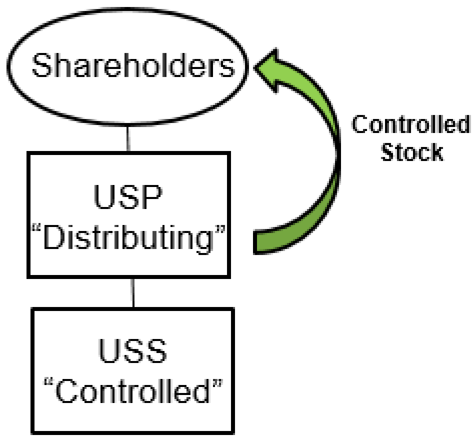
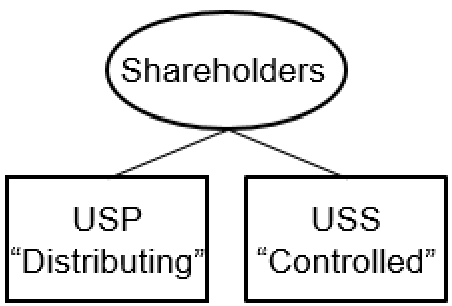
Transaction Costs in a Corporate Separation

Definitions

- Capitalizable - Must be capitalized
- Controlled Corporation - Subsidiary corporation whose stock is distributed in the corporate separation.
- Corporate Separation - Transaction in which a corporation divides into separate corporations, either by: 1) transferring a business to a newly-formed subsidiary and distributing the new subsidiary's stock to some or all of its shareholders, or 2) by distributing the stock of an existing subsidiary to some or all of its shareholders. Typical transaction structures are a spin-off, split-off or split-up.
- Distributing Corporation - Corporation that distributes the stock of a subsidiary (or subsidiaries) to its shareholders.
- Divisive 'D' Reorganization - Corporate separation in which the distributing corporation transfers a business to a newly-formed subsidiary and distributes the stock of the subsidiary to its shareholders.
- Facilitative Cost - Cost incurred in investigating or otherwise pursuing the transaction.
- Spin-Off - Corporate separation in which the distributing corporation distributes the stock of the controlled corporation prorata to its shareholders.
- Split-Off - Corporate separation in which the distributing corporation distributes the stock of a single controlled corporation to one or more (but not all) shareholders in exchange for the distributing corporation's stock held by the receiving shareholder(s).
- Split-Up - Corporate separation in which the distributing corporation distributes the stock of two or more controlled corporations to its shareholders in liquidation. Generally, different shareholders (or groups of shareholders) own the stock of each controlled corporation after the transaction.
- Success-Based Fee - Fee that becomes due and payable upon the successful completion of the transaction to which it relates.
- Transaction Cost - Cost incurred in connection with a transaction.

Transaction and Fact Pattern

Transaction Costs in a Corporate Separation

Diagram of Transaction	Facts
Spin-Off  **Resulting Structure** 	<u>Spin-Off</u> The facts below describe a spin-off, which is a common structure for a corporate separation. The transaction and resulting ownership structure are illustrated at left. USP ("Distributing") wholly owns USS ("Controlled"). Distributing acquired the stock of Controlled from an unrelated party in Year 1 in a transaction qualifying as a tax-free reorganization under IRC 368(a)(1)(A) and 368(a)(2)(E). In Year 1, Distributing incurred investment banking fees and legal fees to acquire Controlled. Distributing capitalized the fees under Treas. Reg. 1.263(a)-5. In Year 1, Controlled incurred investment banking fees and legal fees in connection with Distributing's acquisition of its stock. Controlled capitalized the fees under Treas. Reg. 1.263(a)-5. In Year 5, Distributing decides to separate the Controlled business from its other trades or businesses.

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Transaction and Fact Pattern (cont'd)

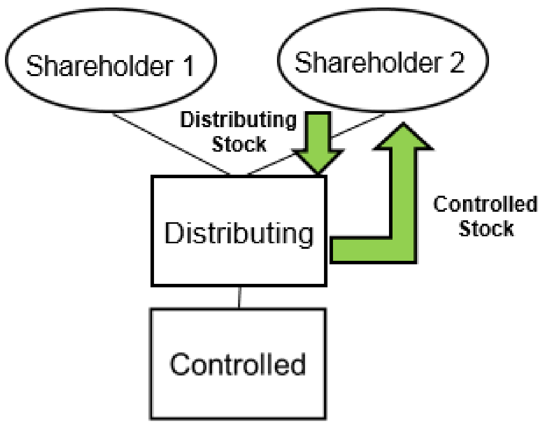
Transaction Costs in a Corporate Separation
Facts
<u>Spin-Off (cont'd)</u> In Year 6, Distributing distributes the stock of Controlled to its shareholders ("Shareholders") pro rata. The distribution is a corporate separation that meets the requirements to qualify for tax-free treatment under IRC 355. After the transaction, each of the Shareholders directly owns the stock of Controlled in the same proportion as their stock ownership of Distributing. Distributing incurs legal fees in both Year 5 and Year 6 in planning and executing the spin-off of Controlled. In Year 6, Distributing deducts the following costs: 1. Legal fees incurred in planning and executing the corporate separation of Controlled, and 2. Costs that facilitated the acquisition of Controlled, which Distributing capitalized in Year 1. In Year 6, Controlled deducts costs that facilitated Distributing's acquisition of its stock, which Controlled capitalized in Year 1.

Transaction and Fact Pattern (cont’d)

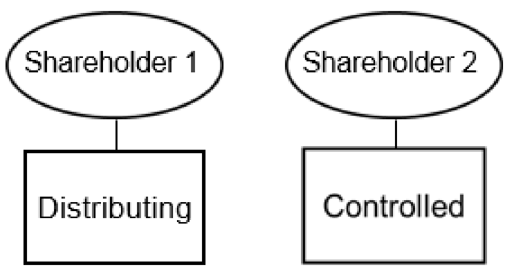
Transaction Costs in a Corporate Separation

Diagram of Transaction

Split-Off



Resulting Structure



Facts

<u>Split-Off</u>

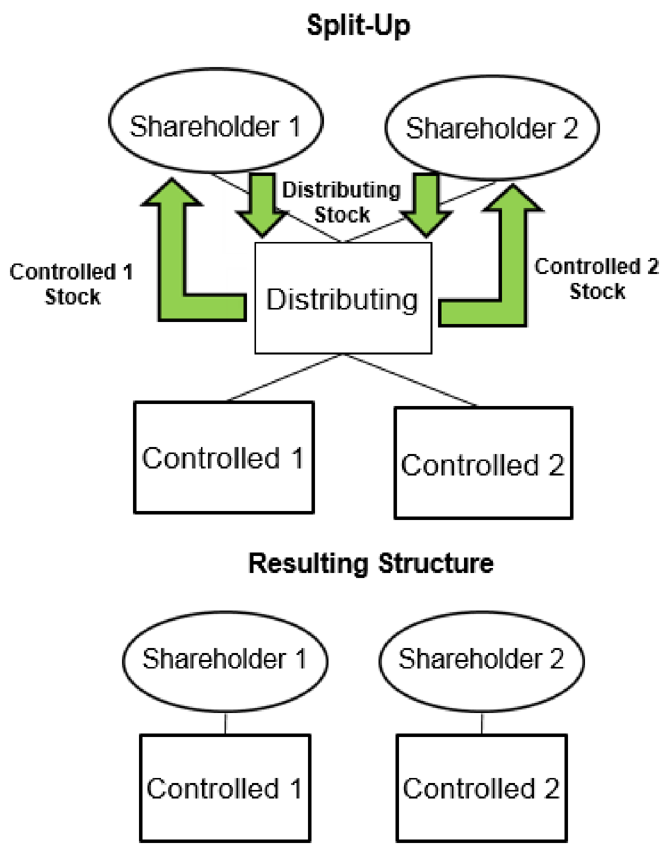
If Distributing distributes the stock of a single controlled subsidiary, the corporate separation could also be structured as a split-off. The transaction and resulting ownership structure are illustrated in the diagrams on this slide.

The facts are the same as in the spin-off, except that in Year 6, Distributing distributes the stock of Controlled to Shareholder 2 in exchange for all of the Distributing stock held by Shareholder 2.

After the transaction, Shareholder 2 directly owns 100% of the stock of Controlled and Shareholder 1 owns 100% of the stock of Distributing.

Transaction and Fact Pattern (cont'd)

Transaction Costs in a Corporate Separation

Diagram of Transaction	Facts
	Split-Up If Distributing distributes the stock of more than one controlled subsidiary, the corporate separation can be structured as a split-up. The transaction and resulting ownership structure are illustrated in the diagrams on this slide. The facts are the same as in the spin-off, except that in Year 6, Distributing distributes the stock of Controlled 1 to Shareholder 1 and the stock of Controlled 2 to Shareholder 2 in liquidation. After the transaction, Shareholder 1 directly owns 100% of the stock of Controlled 1 and Shareholder 2 directly owns 100% of the stock of Controlled 2. Note: The diagram of "Split-Up" on this slide is not representative of all split-ups, which can take different forms. For example, instead of receiving the stock of only one Controlled corporation, each shareholder can receive the stock of both Controlled 1 and Controlled 2 in exchange for their stock in Distributing. As long as all the Distributing stock is redeemed in the exchange and only Controlled 1 and Controlled 2 survive (i.e., Distributing liquidates), the transaction is characterized as a split-up.

Summary of Potential Issues

Transaction Costs in a Corporate Separation	
Issue 1	In the year the corporate separation was completed, did the distributing corporation deduct transaction costs that facilitated the transaction?
Issue 2	In the year the corporate separation was completed, did the distributing corporation deduct costs it previously capitalized as facilitating the acquisition of the controlled corporation?
Issue 3	In the year the corporate separation was completed, did the controlled corporation deduct costs it previously capitalized as facilitating the acquisition of its stock?

All Issues, Step 1: Initial Factual Development

Transaction Costs in a Corporate Separation

The first step is to determine whether the taxpayer executed a corporate separation. A taxpayer that distributes the stock of a controlled corporation in an IRC 355 transaction must report information about the distribution in a statement attached to its return for the year of the distribution, as specified in Treas. Reg. 1.355-5(a)(1). Similarly, a taxpayer that executes a reorganization described in IRC 368(a)(1) must report information about the reorganization in a statement attached to its return for the year in which the reorganization closes, as specified in Treas. Reg. 1.368-3(a).

Fact Element	Resources
Consider the following to determine whether the taxpayer may have executed a corporate separation: ▪ Is there a statement attached to the return disclosing an IRC 355 distribution? ▪ Is there a statement attached to the return disclosing a reorganization under IRC 368(a)(1)? ▪ Do any other forms or schedules (e.g., Form 1120, (Schedule UTP), Uncertain Tax Position Statement; Form 8886, Reportable Transaction Disclosure Statement) disclose a corporate separation? ▪ Do SEC filings or the company's website (press releases or annual shareholder report) discuss a corporate restructuring, separation of business units and/or discontinued operations? ▪ Do business and industry publications or public news media report that the taxpayer engaged in a spin-off, split-off or split-up? ▪ Does Form 851, Affiliations Schedule, identify reductions in the stock ownership of a subsidiary?	▪ IRC 355 ▪ IRC 368(a)(1) ▪ Treas. Reg. 1.355-5(a)(1) ▪ Treas. Reg. 1.368-3(a) ▪ Form 1120, Schedule UTP - *Uncertain Tax Position Statement* ▪ Form 8886 - *Reportable Transaction Disclosure Statement* ▪ Form 851 - *Affiliations Schedule*

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Issue 1, Step 2: Review Potential Issues

Transaction Costs in a Corporate Separation
Issue 1
In the year the corporate separation was completed, did the distributing corporation deduct transaction costs that facilitated the transaction?

Explanation of Issue	Resources
Deductions are a matter of legislative grace and the taxpayer bears the burden of proof to establish its right to a claimed deduction. *INDOPCO*, 503 U.S. at 84, citing *Interstate Transit Lines v. Commissioner,* 319 U.S. 590 (1943); *Deputy v. Du Pont,* 308 U.S. 488 (1940); *New Colonial Ice Co. v. Helvering,* 292 U.S. 435 (1934)*; Welch v. Helvering*, 290 U.S. 111 (1933). The capitalization rules of IRC 263 take precedence over the deduction rules of IRC 162, thereby preventing capital expenditures from being deducted currently under IRC 162. *U.S. Bancorp v. Commissioner*, 111 T.C. 231 (1998), citing *Commissioner v. Teller*, 383 U.S. 687 (1966); *Deputy v. DuPont*; *Welch v. Helvering*. In determining whether a cost is a capital expenditure, the *INDOPCO* court noted that deductions are exceptions to the norm of capitalization. *INDOPCO,* 503 U.S. at 84. The Court stated that deductions are specifically enumerated and thus are subject to disallowance in favor of capitalization. *Id*. Capital expenditures, by contrast, are not exhaustively enumerated; rather than providing a complete list of nondeductible expenditures, IRC 263 serves as a general means of distinguishing capital expenditures from current expenses. *Id*. A cost that facilitates a restructuring, recapitalization, or reorganization of the capital structure of a business entity, including reorganizations under IRC 368 and distributions of stock under IRC 355, must be capitalized. Treas. Reg. 1.263(a)-5(a)(4).	▪ *INDOPCO, Inc. v. Commissioner* - 503 U.S. 79 (1992) ▪ *Interstate Transit Lines v. Commissioner* - 319 U.S. 590 (1943) ▪ *Deputy v. Du Pont* - 308 U.S. 488 (1940) ▪ *New Colonial Ice Co. v. Helvering* - 292 US. 435 (1934) ▪ *Welch v. Helvering* - 290 U.S. 111 (1933) ▪ IRC 263 ▪ IRC 162 ▪ *U.S. Bancorp v. Commissioner* - 111 T.C. 231 (1998) ▪ *Commissioner v. Teller* - 383 U.S. 687 (1966) ▪ IRC 368 ▪ IRC 355 ▪ Treas. Reg. 1.263(a)-5(a)(4)

Transaction Costs in a Corporate Separation

Issue 1

Explanation of Issue	Resources
Law established prior to the final regulations under Treas. Reg. 1.263(a)-5 requires costs incurred for a corporate reorganization or restructuring to be capitalized when the transaction: 1. Changes the capital structure of the surviving corporation and creates an intangible asset, or 2. Results in a benefit that extends beyond the year in which the costs are incurred. See *Bilar Tool & Die v. Commissioner*, 530 F.2d 708 (6th Cir.1976); *INDOPCO*; *E.I. DuPont de Nemours v. U.S.*, 432 F.2d 1052 (3rd Cir. 1970); *The Farmer's Union Corp. v. Commissioner*, 300 F.2d 197 (9th Cir. 1962); see also Rev. Rul. 67-125. In *INDOPCO*, the U.S. Supreme Court recognized and reaffirmed a long line of cases requiring the capitalization of costs incurred in changing a corporate structure for the benefit of future operations. Describing the doctrine as a "well-established rule," the Court reiterated that deductions for professional fees have been disallowed and capitalized in a wide variety of cases concerning changes to corporate structures, including a division of a corporation into two parts. The Court further stated that "a capital expenditure is amortized and depreciated over the life of the relevant asset, or, where no specific asset or useful life can be ascertained, is deducted upon dissolution of the enterprise."	▪ Treas. Reg. 1.263(a)-5 ▪ *Bilar Tool & Die v. Commissioner* - 530 F.2d 708 (6th Cir. 1976) ▪ *INDOPCO, Inc. v. Commissioner* - 503 U.S. 79 (1992) ▪ *E.I. DuPont de Nemours v. U.S.* - 432 F.2d 1052 (3d Cir. 1970) ▪ *The Farmer's Union Corp. v. Commissioner* - 300 F.2d 197 (9th Cir. 1962) ▪ Rev. Rul. 67-125

Issue 1, Step 2: Review Potential Issues (cont'd)

Transaction Costs in a Corporate Separation
Issue 1

Explanation of Issue	Resources
NOTE: In PLR 8816026, the Service ruled that under the "origin of the claim" doctrine, a settlement payment made by a Controlled corporation under a pre-spin-off agreement was integrally related to the spin-off and as such, was a capital expenditure incident to a reorganization and not deductible as an ordinary and necessary business expense.	▪ PLR 8816026

Issue 1, Step 2: Review Potential Issues (cont’d)

Transaction Costs in a Corporate Separation

Issue 1

Explanation of Issue	Resources
A cost facilitates a transaction described in Treas. Reg. 1.263(a)-5(a) if it is paid in investigating or otherwise pursuing the transaction, as determined based on all of the facts and circumstances. The fact that a cost would (or would not) have been paid but for the transaction is relevant but does not determine whether the amount facilitates the transaction. See Treas. Reg. 1.263(a)-5(b)(1). The foregoing definition of “facilitate” is very broad and encompasses many costs, including: ▪ Investment banking fees for a fairness opinion regarding the corporate separation; ▪ Costs to develop materials for soliciting and obtaining shareholder approval of the transaction. A cost that is payable upon the successful completion of a transaction (a “success-based fee”) is presumed to facilitate the transaction and must be capitalized unless the taxpayer provides sufficient documentation to support an allocation of some or all of the cost to activities that do not facilitate the transaction. See Treas. Reg. 1.263(a)-5(f).	▪ Treas. Reg. 1.263(a)-5(a) ▪ Treas. Reg. 1.263(a)-5(b)(1) ▪ Treas. Reg. 1.263(a)-5(f) ▪ Treas. Reg. 1.263(a)-5(c)(3)

Transaction Costs in a Corporate Separation

Issue 1

Explanation of Issue	Resources
! **CAUTION:** Exception - A cost incurred in investigating or otherwise pursuing a corporate divesture or a corporation's distribution of stock to its shareholders does not facilitate the transaction if the divestiture or distribution is required by law, regulatory mandate or court order. Treas. Reg. 1.263(a)-5(c)(3); see also Treas. Reg. 1.263(a)-5(l), Ex. 17.	▪ Treas. Reg. 1.263(a)-5(l)

Transaction Costs in a Corporate Separation

Issue 1

Explanation of Issue	Resources
Treas. Reg. 1.263(a)-5(g), which discusses the treatment of costs required to be capitalized for transactions described in Treas. Reg. 1.263(a)-5(a), does not address costs that facilitate a corporate separation and other authorities do not support a recovery of such costs, unless the transaction is abandoned. A facilitative cost capitalizable under Treas. Reg. 1.263(a)-5(a) may be deductible under IRC 165 if the transaction is abandoned. See Treas. Reg. 1.263(a)-5(l), Ex. 3. Also, certain transaction costs capitalized for a reorganization may be deductible under IRC 165 if the underlying property is abandoned or sold. See *McCrory v. Commissioner*, 651 F.2d 828 (2d Cir. 1981). IRC 165(a) allows a deduction for "any loss sustained during the taxable year and not compensated for by insurance or otherwise" that is evidenced by closed and completed transactions, fixed by identifiable events and actually sustained during the taxable year. Whether the foregoing tests are met is a factual question and is determined on a case-by-case basis. *Nicolazzi v. Commissioner*, 79 T.C. 109 (1982). Only a bonafide loss is allowable. Substance and not mere form govern in determining whether a loss is deductible. Treas. Reg. 1.165-1(b) and (d)(1).	▪ Treas. Reg. 1.263(a)-5(g) ▪ Treas. Reg. 1.263(a)-5(a) ▪ Treas. Reg. 1.263(a)-5(l) ▪ IRC 165 ▪ *McCrory v. Commissioner* - 651 F.2d 828 (2d Cir. 1981) ▪ *Nicolazzi v. Commissioner* - 79 T.C. 109 (1982) ▪ Treas. Reg. 1.165-1(b) ▪ Treas. Reg. 1.165-1(d)

Transaction Costs in a Corporate Separation

Issue 1

Explanation of Issue	Resources
In the year the loss is actually sustained, a deduction under IRC 165(a) is allowed for a loss from the sudden termination of the usefulness of nondepreciable property when a business or transaction entered into for profit is discontinued, or when the property is permanently discarded from use. Treas. Reg. 1.165-2(a). In *McCrory*, which did not involve a distribution under IRC 355, the U.S. Court of Appeals Second Circuit held that reorganization costs capitalized incident to two reorganizations under IRC 368(a)(1)(A) must be viewed as incurred in connection with both a raising of capital and an asset acquisition. The Court held that the taxpayer should be allowed a deduction, either as an abandonment loss under IRC 165, or as a reduction of capital gain through an increase in basis under IRC 1011, for the portion of the costs incurred to acquire the assets when the assets and related businesses were completely and finally disposed of; however, the costs capitalized for the raising of capital are never deductible. Upon remand to the district court, the Second Circuit indicated the taxpayer bore the burden of allocating the capitalized expenses between the purchase and the capital-raising aspects of the transaction.	▪ IRC 165(a) ▪ Treas. Reg. 1.165-2(a) ▪ *McCrory v. Commissioner* - 651 F.2d 828 (2d Cir. 1981) ▪ IRC 355 ▪ IRC 368(a)(1)(A) ▪ IRC 165 ▪ IRC 1011

Issue 1, Step 3: Additional Factual Development

Transaction Costs in a Corporate Separation

Issue 1

Fact Element	Resources
If the distributing corporation executed a corporate separation, determine whether the corporation incurred and deducted transaction costs that facilitated the transaction. ▪ Review the distributing corporation's financial statements for disclosures of costs incurred in connection with a restructuring, reorganization or discontinued operations. ▪ Review Capital IQ M&A/Private Placements for a Spin-Off/Split-Off transaction. The Transaction Details lists the advisors that performed services for the transaction. ▪ Review Schedule M-3, Part III, Lines 23 through 25, for current-year acquisition or reorganization legal fees, accounting fees, investment banking fees and/or other costs incurred and deducted. ▪ Review the detail of Form 1120, Line 26 and Schedule M-3, Part III, Line 37 (2016) for other expenses that may have been incurred and deducted for the corporate separation (e.g., loss on abandonment). ▪ Analyze professional fees reported on Form 1120, Line 26 to determine whether the current-year professional fees increased significantly in comparison to prior years. ▪ Review Schedule M-3, Part II, Line 23e, for reported abandonment losses.	▪ Form 1120, Schedule M-3 - *Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More* ▪ Form 1120 - *U.S. Corporation Income Tax Return*

Issue 1, Step 3: Additional Factual Development (cont'd)

Transaction Costs in a Corporate Separation
Issue 1

Fact Element	Resources
Determine whether the transaction costs deducted by the distributing corporation facilitated the transaction. ▪ Review the transaction costs study or analysis. ▪ Review or develop a timeline for the transaction. ▪ Review engagement letters, contacts or agreements (including amendments) and/or invoices from service providers to determine the nature and scope of the services rendered. ▪ Request a presentation and/or a written explanation as to how the distributing corporation determined the tax treatment of transaction costs incurred for the corporate separation, including the authorities it relied on in reaching its conclusions. The Practice Unit, *Examining a Transaction Costs Issue*, discusses in detail the rules for determining if a cost facilitates a transaction described in Treas. Reg. 1.263(a)-5(a).	▪ Practice Unit - *Examining a Transaction Costs Issue*, DCN: CDA/P/225_01_01

Transaction Costs in a Corporate Separation

Issue 1

Explanation of Adjustment	Resources
DECISION POINT: Based on the evidence, determine whether the distributing corporation deducted transaction costs that facilitated the corporate separation. If so, then consider whether: ▪ The transaction costs to facilitate the corporate separation should be capitalized under Treas. Reg. 1.263(a)-5(a)(4); ▪ The distributing corporation abandoned the corporate separation and sustained a bona fide, uncompensated loss evidenced by closed and completed transactions and fixed by identifiable events, as required under Treas. Reg. 1.165-1(b); and ▪ The distributing corporation has provided sufficient evidence to support that it is entitled to deduct the transaction costs that facilitated the abandoned corporate separation. See *INDOPCO, Inc. v. Commissioner*; *Interstate Transit Lines v. Commissioner*; *Deputy v. Du Pont*; *New Colonial Ice Co. v. Helvering; Welch v. Helvering*.	▪ Treas. Reg. 1.263(a)-5(a)(4) ▪ *INDOPCO v. Commissioner* - 503 U.S. 79 (1992) ▪ Treas. Reg. 1.165-1(b) ▪ *Interstate Transit Lines v. Commissioner* - 319 U.S. 590 (1943) ▪ *Deputy v. Du Pont,* 308 U.S. 488 (1940) ▪ *New Colonial Ice Co. v. Helvering* - 292 US. 435 (1934) ▪ *Welch v. Helvering* - 290 U.S. 111 (1933)

Issue 2, Step 2: Review Potential Issues

Transaction Costs in a Corporate Separation
Issue 2
In the year the corporate separation completed, did the distributing corporation deduct costs it previously capitalized as facilitating the acquisition of the controlled corporation?

Explanation of Issue	Resources
In the facts described on Slide 5, the distributing corporation acquired the stock of the controlled corporation in a transaction qualifying as a tax-free reorganization under IRC 368(a)(1)(A) and IRC 368(a)(2)(E) in a tax year prior to the year of the IRC 355 distribution. . A cost that facilitates a reorganization under IRC 368 must be capitalized under Treas. Reg. 1.263(a)-5(a)(4). Treas. Reg. 1.263(a)-5(g) discusses the treatment of costs required to be capitalized for transactions described in Treas. Reg. 1.263(a)-5(a). However, Treas. Reg. 1.263(a)-5(g)(1) is reserved and therefore does not provide guidance regarding the treatment of costs capitalized as facilitating a tax-free transaction described in Treas. Reg. 1.263(a)-5(a)(4), which includes a reorganization under IRC 368(a)(1). Certain transaction costs capitalized in a reorganization may be deductible under IRC 165 or increase the basis in the underlying property under IRC 1011 when such property is abandoned or sold. See *McCrory v. Commissioner*, 651 F.2d 828 (2d Cir. 1981).	▪ IRC 368(a)(1)(A) ▪ IRC 368(a)(2)(E) ▪ IRC 355 ▪ IRC 368 ▪ Treas. Reg. 1.263(a)-5(a)(4) ▪ Treas. Reg. 1.263(a)-5(g) ▪ Treas. Reg. 1.263(a)-5(a) ▪ Treas. Reg. 1.263(a)-5(g)(1) ▪ IRC 368(a)(1) ▪ IRC 165 ▪ IRC 1011 ▪ *McCrory v. Commissioner* - 651 F.2d 828 (2d Cir. 1981).

Issue 2, Step 2: Review Potential Issues (cont'd)

Transaction Costs in a Corporate Separation

Issue 2

Explanation of Issue	Resources
IRC 165(a) allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise that is evidenced by closed and completed transactions, fixed by identifiable events and actually sustained during the taxable year. Whether the foregoing tests are met is a factual question and is determined on a case-by-case basis. *Nicolazzi v. Commissioner*, 79 T.C. 109 (1982). Only a bonafide loss is allowable. Substance and not mere form govern in determining whether a loss is deductible. Treas. Reg. 1.165-1(b) and (d)(1). In the year the loss is actually sustained, a deduction under IRC 165(a) is allowed for a loss from the sudden termination of the usefulness of nondepreciable property when a business or transaction entered into for profit is discontinued, or when the property is permanently discarded from use. Treas. Reg. 1.165-2(a).	▪ 165(a)(1) ▪ *Nicolazzi v. Commissioner* - 79 T.C. 109 (1982) ▪ Treas. Reg. 1.165-1(b) ▪ Treas. Reg. 1.165-1(d)(1) ▪ Treas. Reg. 1.165-2(a)

Issue 2, Step 3: Additional Factual Development

Transaction Costs in a Corporate Separation
Issue 2

Fact Element	Resources
Determine whether the distributing corporation deducted costs it previously capitalized as facilitating the acquisition of the controlled corporation. Review financial statement disclosures of expenses for discontinued operations or permanent impairments. Review the return for deductions and losses reported on the following lines and schedules: ▪ Schedule M-3, Part II, Line 23e, Abandonment losses; ▪ Schedule M-3, Part III, Line 27, Amortization deduction of acquisition, reorganization and start-up costs; ▪ Schedule M-3, Part III, Line 28, Other amortization or impairment write-offs; and ▪ Detail of Form 1120, Line 26, Other Deductions	▪ Form 1120, Schedule M-3 - *Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More* ▪ Form 1120 - *U.S. Corporation Income Tax Return*

Issue 2, Step 4: Develop Arguments

Transaction Costs in a Corporate Separation

Issue 2

Explanation of Adjustment	Resources
DECISION POINT: In the year the corporate separation was completed, did the distributing corporation deduct costs it previously capitalized as facilitating the acquisition of the controlled corporation? If so, consider whether: ▪ The distributing corporation abandoned the controlled corporation's stock when it distributed such stock in the corporate separation; ▪ The corporate separation caused the distributing corporation to sustain a bonafide, uncompensated loss evidenced by closed and completed transactions and fixed by identifiable events, as required under Treas. Reg. 1.165-1(b), with respect to the previously capitalized transaction costs; and ▪ The distributing corporation has provided sufficient evidence to support that it is entitled to deduct the previously capitalized transaction costs that facilitated its acquisition of the controlled corporation's stock. See *INDOPCO, Inc. v. Commissioner*; *Interstate Transit Lines v. Commissioner*; *Deputy v. Du Pont*; *New Colonial Ice Co. v. Helvering; Welch v. Helvering*.	▪ Treas. Reg. 1.165-1(b) ▪ *INDOPCO v. Commissioner* - 503 U.S. 79 (1992) ▪ *Interstate Transit Lines v. Commissioner* - 319 U.S. 590 (1943) ▪ *Deputy v. Du Pont* - 308 U.S. 488 (1940) ▪ *New Colonial Ice Co. v. Helvering* - 292 US. 435 (1934) ▪ *Welch v. Helvering* - 290 U.S. 111 (1933)

Issue 3, Step 2: Review Potential Issues

Transaction Costs in a Corporate Separation
Issue 3
In the year the corporate separation was completed, did the controlled corporation deduct costs it previously capitalized as facilitating the distributing corporation's acquisition of its stock?

Explanation of Issue	Resources
IRC 165(a) allows a deduction for a bonafide loss sustained during the taxable year for which the taxpayer is not compensated by insurance or otherwise. The loss must be evidenced by closed and completed transactions, fixed by identifiable events and actually sustained during the taxable year, as determined on a case-by-case basis. Treas. Reg. 1.165-1(b); Treas. Reg. 1.165-1(d)(1); *Nicolazzi v. Commissioner*. *INDOPCO* required the capitalization of costs incurred by the target of a taxable stock acquisition since the target was expected to receive "synergistic and resource benefits" through its association with the acquiring corporation. The *INDOPCO* court stated that "a capital expenditure is amortized and depreciated over the life of the relevant asset, or, where no specific asset or useful life can be ascertained, is deducted upon dissolution of the enterprise." In TAM 200502039, the Service stated that the target of a prior acquisition could not deduct, as an abandonment loss under IRC 165, costs it previously capitalized as facilitating its acquisition upon its dissolution under state law where prior to its dissolution, the target distributed its assets to another member of its affiliated group in liquidation.	▪ IRC 165 ▪ Treas. Reg. 1.165-1(b) ▪ Treas. Reg. 1.65-1(d)(1) ▪ *Nicolazzi v. Commissioner* - 79 T.C. 109 (1982) ▪ *INDOPCO v. Commissioner* - 503 U.S. 79 (1992) ▪ TAM 200502039

Issue 3, Step 3: Additional Factual Development

Transaction Costs in a Corporate Separation
Issue 3

Fact Element	Resources
Determine if in the year the corporate separation completed, the controlled corporation deducted costs it previously capitalized as facilitating the distributing corporation's acquisition of its stock. ▪ Review Schedule M-3, Part II, for abandonment losses. ▪ Review Schedule M-3, Part III, Line 27 for any amortization deduction of acquisition, reorganization or start-up costs. ▪ Review Schedule M-3, Part III, Line 28 for impairment write-offs. ▪ Review the detail of Form 1120, Line 26, for previously capitalized costs deducted in Other Deductions.	▪ Form 1120, Schedule M-3 - *Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More* ▪ Form 1120 - *U.S. Corporation Income Tax Return*

Issue 3, Step 4: Develop Arguments

Transaction Costs in a Corporate Separation

Issue 3

Explanation of Adjustment	Resources
DECISION POINT: Did the controlled corporation deduct costs it previously capitalized as facilitating the acquisition of its stock? If so, then consider whether: ▪ The controlled corporation dissolved in the corporate separation; ▪ The synergistic and resource benefits associated with the controlled corporation's affiliation with the distributing corporation terminated in the corporate separation. See *INDOPCO*; ▪ The corporate separation caused the controlled corporation to sustain a bonafide, uncompensated loss evidenced by closed and completed transactions and fixed by identifiable events, as required under Treas. Reg. 1.165-1(b), with respect to the previously capitalized costs; and ▪ The controlled corporation has provided sufficient evidence to support that it is entitled to deduct the previously capitalized costs that facilitated the acquisition of its stock. See *INDOPCO, Inc. v. Commissioner*; *Interstate Transit Lines v. Commissioner*; *Deputy v. Du Pont*; *New Colonial Ice Co. v. Helvering; Welch v. Helvering*.	▪ *INDOPCO v. Commissioner* - 503 U.S. 79 (1992) ▪ Treas. Reg. 1.165-1(b) ▪ *Interstate Transit Lines v. Commissioner* - 319 U.S. 590 (1943) ▪ *Deputy v. Du Pont* - 308 U.S. 488 (1940) ▪ *New Colonial Ice Co. v. Helvering* - 292 US. 435 (1934) ▪ *Welch v. Helvering* - 290 U.S. 111 (1933)

Index of Referenced Resources

Transaction Costs in a Corporate Separation
IRC 162
IRC 165
IRC 263
IRC 355
IRC 368
IRC 1011
Treas. Reg. 1.165-1
Treas. Reg. 1.165-2
Treas. Reg. 1.263(a)-5
Treas. Reg. 1.355-5
Treas. Reg. 1.368-3
Welch v. Helvering - 290 U.S. 111 (1933)
New Colonial Ice Co. v. Helvering - 292 US. 435 (1934)
Deputy v. Du Pont - 308 U.S. 488 (1940)
Interstate Transit Lines v. Commissioner - 319 U.S. 590 (1943)
Commissioner v. Teller - 383 U.S. 687 (1966)

Index of Referenced Resources (cont'd)

Transaction Costs in a Corporate Separation
INDOPCO v. Commissioner - 503 U.S. 79 (1992)
U.S. Bancorp v. Commissioner - 111 T.C. 231 (1998)
McCrory v. Commissioner - 651 F.2d 828 (2nd Cir. 1981)
E.I. DuPont de Nemours v. U.S. - 432 F.2d 1052 (3rd Cir. 1970)
Bilar Tool & Die v. Commissioner - 530 F.2d 708 (6th Cir.1976)
The Farmers Union Corp. v. Commissioner - 300 F.2d 197 (9th Cir. 1962)
Nicolazzi v. Commissioner - 79 T.C. 109 (1982)
Rev. Rul. 67-125
PLR 8816026
TAM 200503026
TAM 200502039
Form 1120 - *U.S. Corporation Income Tax Return*
Form 1120, Schedule M-3 - *Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More*
Form 1120, Schedule UTP - *Uncertain Tax Position Statement*
Form 8886 – *Reportable Transaction Disclosure Statement*
Form 851 – *Affiliations Schedule*

Training and Additional Resources

Transaction Costs in a Corporate Separation	
Type of Resource	**Description(s)**
Saba Meeting Sessions	▪ *Treatment of Transaction Costs Under Treas. Reg. 1.263(a)-5: The Basics* - 2013 Centra ▪ *Transaction Costs Under Treas. Reg. 1.263-5(f): Success-Based Fees* - 2013 Centra ▪ *Divisive 'D' Reorganizations* - 2016 Saba Meeting
Issue Toolkits	▪ Flow Chart - Final INDOPCO Regulations Treas. Reg. 1.263(a)-5 ▪ Job Aid - Success-Based Fees Frequently Asked Questions ▪ Job Aid - Significant Guidance - Intangibles Law - Treas. Reg. 1.263(a)-5
White Papers / Guidance	▪ Job Aid – Treatment of Costs in an IRC 355 Transaction
Other Training Materials	▪ *Transaction Costs and Treas. Reg. 1.263(a)-5* PPT - 2011-10 ▪ *Best Practices for Working a Transaction Costs Issue (Part I)* PPT - 2015-02 ▪ *Best Practices for Working a Transaction Costs Issue (Part II)* PPT - 2015-04

Glossary of Terms and Acronyms

Term/Acronym	Definition
CCA	Chief Counsel Advisory
IRC	Internal Revenue Code
PLR	Private Letter Ruling
Rev. Rul.	Revenue Ruling
SEC	Securities and Exchange Commission
TAM	Technical Advice Memorandum
Treas. Reg.	Treasury Regulation

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Index of Related Practice Units

Associated UIL(s)	Related Practice Unit	DCN
1.263.14-00	*Examining a Transaction Costs Issue*	CDA/P/225_01-01